

Hypothetical Group Case Study

Jumbo Airlines' Competitive Challenge

Jumbo Airlines is the largest carrier in Country A offering flights across an extensive network of domestic and international routes. It is regarded as the leading airline on long distance routes to and from Country A. Jumbo's president Mr. Smith is very concerned with increased competition faced by Jumbo Airlines in global markets and the fast growth of Minute Airways on domestic routes. Minute Airways began service in 2010 but has since grown to control 30% of domestic capacity in Country A. Moreover, Mr. Smith recently dined out with a senior Vice President from Heavy Airlines, the flag carrier of neighbouring Country B, and learned that Minute Airways had been making roadways to enter into a cooperation agreement with Heavy Airlines. Turns out, Minute Airways has applied for authority to offer flights on several international routes to other countries and it has placed an order for three B777 to be delivered over the next six months. Mr. Smith left the dinner with a headache but determined to find a quick solution to the mounting competitive threat!

Mr. Smith has asked you to create a Dream Team which is tasked with developing a strategy to increase competitiveness Jumbo Airlines' competitiveness in international and domestic markets. In particular, rapid expansion of Minute Airways domestically and increased penetration of Heavy Airlines on major international long-distance routes is hindering Jumbo's ability to expand quickly in certain markets. It is time to put a stop to Minute Airways' mission to encroach on your domestic turf! It is also time to regain dominance on long-distance routes internationally!

An alliance with a strong partner could help curtail the growing popularity of competing carriers. Securing an alliance with Heavy Airlines seems like an obvious solution. In recent years, Heavy Airlines has expanded its service to Country A and it now serves an increasing number of secondary cities in Country A in addition to major hubs. The alliance would be a strong enhancement of Jumbo's current route network, as, among other benefits, it would provide access to Heavy's voluminous traffic. However, your strategy needs to be carefully crafted to outsmart any lucrative offers Minute Airways may have already made.

The meeting of the Board of Directors is scheduled for this Saturday, 14 February 2015. Mr. Smith asked that the Dream Team present ideas to the board of directors in a series of 20-minute presentations that address specific questions on how to proceed. Your legal team has to apply comprehensive knowledge of the applicable laws and the airline industry. Luckily, junior lawyers and analysts at Jumbo, working overtime hours in the past three weeks, have already assembled preliminary materials to assist the Dream Team.

Questions for Groups

GROUP 1

1. What type of agreement should Jumbo seek with Heavy? Would Jumbo and Heavy have a commercial interest in entering a metal-neutral joint venture? What impediments, if any, does membership in global alliances present for the bilateral partnership between Jumbo and Heavy?

GROUP 2

2. Would the current bilateral air service agreement between Country A and Country B hinder the ability of Jumbo and Heavy to implement the agreement in question 1? Which provisions would need to be added, removed or modified in order to enable the agreement?

GROUP 3

3. How would the agreement in question 1 contribute to Mr. Smith's business strategy to curtail Minute Airways' growth in domestic markets and the threat of mounting competition in international markets? What form of state aid could Jumbo request / obtain from Country A to improve its competitive position vis-à-vis rival carriers?

GROUP 4

4. What types of regulatory approvals would Jumbo and Heavy need to seek in order to implement the agreement in question 1? What applications would Jumbo and Heavy have to file in order to support their plan of action? What tests would be applied by the respective regulatory agencies to review the agreement?

GROUP 5

5. The airport in Pear is slot constrained. Star alliance carriers heavily dominate the airport where they control 90% of take off and landing slots. How would this impact the ability of Jumbo and Heavy to obtain approvals and implement the agreement in question 1? How would the agreement impact the allocation of airport slots at Pear? *(Hint: consult supplementary readings for modules on airline alliances and mergers)*

GROUP 6

6. What objections can Minute Airways raise before the reviewing competition commission and the regulatory agency in Country A and Country B respectively? How should Jumbo and Heavy respond to those objections? *(Hint: consult supplementary readings for modules on airline alliances and mergers)*

Background Documents

APPENDIX A - Airline Background

JUMBO AIRLINES

Founded in the 1930s, Jumbo Airlines is currently the largest domestic and international airline in Country A. The family of Jumbo's airline brands operates regional, domestic and international services. Jumbo Airlines' main business is the transportation of passengers using two complementary airline brands – Jumbo Airlines and Jumbo Regional Air. The airline's portfolio of subsidiary businesses includes an air cargo transportation company.

Jumbo Airlines was privatized in 1995 and currently the airline employs over 20,000 people. It accounts for approximately 70% of domestic capacity in Country A. Jumbo Airlines is a member of the SkyTeam marketing alliance.

HEAVY AIRLINES

Set up in the 1920s, Heavy Airlines is an international and domestic airline group in Country B, which provides air passenger and cargo transport services within Country B as well as to and from Country A and a number of other neighbouring countries. The company maintains subsidiary businesses providing engineering solutions, booking systems and ground handling services.

Heavy Airlines is the flag carrier of Country B that currently employs approximately 25,000 people, most of them located in Country B. The airline currently controls 100% of all domestic flights in Country B. Heavy Airlines is a member of the Star marketing alliance.

MINUTE AIRWAYS

Formerly Little Airline, Minute Airways was founded in 2010 and is currently the second largest carrier in Country A, accounting for 30% of domestic capacity. It was established with 3 aircraft operating on a single route but has since growth to service many cities in County A. Minute Airlines maintains hubs in Bamboo and Willow, offering service domestically using a fleet of Boeing 737s.

APPENDIX B - Aviation Market Background

COUNTRY A

For many years, aviation was a heavily regulated industry in country A. Domestic markets were served by two airlines that received government support aimed at maintaining good financial position. Beginning in the early 1990s, the country adopted a course to deregulate the domestic market. This initiative culminated in the deregulation of fares, capacity controls, and route entry. Presently, Jumbo Airlines is the largest domestic carrier, carrying approximately 70% of domestic traffic. Minute Airways carries the remaining 30% of traffic on domestic routes.

Liberalization of international service has been less successful. Since its founding, Jumbo Airlines has been the sole designated carrier on international routes to and from Country A. As part of the initiative to liberalize international aviation, the government of Country A created a special commission to study the impact of future liberalization on international air service to and from Country A. Under “grandfather” provisions, Jumbo Airlines would be allowed to keep its existing international route authorities. The policy of liberalizing international routes has not been adopted or enforced yet. Jumbo Airlines is Country A’s largest international carrier, carrying 35% of all international traffic to and from Country A. The air service agreement of 1995 regulates the provision of air transportation services between Country A and Country B, as well as services that touch points outside either country. For instance, Jumbo Airlines non-stop flights between Peach and San Francisco are fifth-freedom flights authorized under the 1995 air service agreement.

COUNTRY B

Heavy Airlines is the principal carrier in Country B. The domestic aviation market in country B was heavily regulated from the 1940s to the 1980s, with Heavy being the monopoly carrier in Country A during that period. Beginning in the late 1980s, any airline (including foreign-owned carriers) has been able to operate domestically in Country B so long as it obtained an operator certificate from the Civil Aviation Authority in Country B. No foreign carrier has applied to fly domestically in Country B. Ownership restrictions apply to carriers seeking to provide international service to and from Country B due to ownership requirements in bilateral agreements.

International service between Country B and other countries is regulated by Country B’s current air service agreements. The air service agreement of 1995 regulates the provision of air transportation services between Country B and Country A, as well as services that touch points outside either country. Currently, only Heavy Airlines and Jumbo Airlines are designated to fly between Country A and Country B.

APPENDIX C - Privatization Law (relevant excerpts only)

Jumbo Airlines Privatization Act of 1995

1. Definitions

“Corporation” means Jumbo Airlines, a corporation continued under the laws of Country A.

2. The articles of continuance of the Corporation shall contain

(a) provisions imposing constraints on the issue, transfer and ownership, including joint ownership, of voting shares of the Corporation to prevent non- residents from holding, beneficially owning or controlling, directly or indirectly, otherwise than by way of security only, in the aggregate voting shares to which are attached more than 25%, or any higher percentage that the Cabinet may by regulation specify, of the votes that may ordinarily be cast to elect directors of the Corporation; and

(b) provisions respecting the counting or prorating of votes cast at any meeting of shareholders of the Corporation and attached to voting shares of the Corporation that are held, beneficially owned or controlled, directly or indirectly, by non-residents so as to limit the counting of those votes to not more than 25%, or any higher percentage specified for the purposes of paragraph (a), of the total number of votes cast by shareholders at that meeting.

APPENDIX D - Antitrust Laws (relevant excerpts only)

In Country A, the *Competition Act* of 1970 sets out the law applicable to strategic alliances and mergers & acquisitions. The Jumbo Busters Commission enforces the *Competition Act*. In Country B, the *Commerce Protection Act* of 1980 applies to strategic alliances and mergers & acquisitions. The Heaving Regulating Ministry of Transport enforces the *Commerce Protection Act*.

The Competition Act, 1970

Subsection 30(1) of the Act sets out the standard applicable to the equity transaction. It states in relevant part:

“A corporation must not directly or indirectly:
(a) acquire shares in the capital of a body corporate; or
(b) acquire any assets of a person if the acquisition would have the effect, or be likely to have the effect, of substantially lessening the competition in a market.”

Section 45 of the Act applies to strategic alliances. Section 45 prohibits:

“the making of or the giving effect to contracts, arrangements or understandings that have the purpose or effect of substantially lessening competition in a market or which contain an exclusionary provision.”

The provisions of sections 30 and 45 may be declared inapplicable if the acquisition or the contract, arrangement or understanding in question creates efficiency gains and consumers receive a fair share of the resulting gains. The Act states in relevant part:

“The provisions of sections 30 and 45 may be declared inapplicable in the case if:
- the acquisition of assets, or
- the contract, arrangement or understanding
contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit.”

Section 86 of the Act “provide a mechanism for authorisation of existing contracts for the acquisition of shares or assets, arrangements or understandings provided the contract, arrangement or understanding is conditional on authorisation being granted.” An authorisation under subsection 86(9) of the Act would protect airlines from criminal prosecution or civil legal action for potential breaches of section 30 or section 45 of the Act.

The Commerce Protection Act, 1980

Section 57 of the Act applies to equity transactions. It states in relevant part:

“(1) A person must not acquire assets of a business or shares if the acquisition would have or would be likely to have, the effect of substantially lessening competition in the market.”

Section 37 of the Act applies to strategic alliances. It states in relevant part:

“(1) No person shall enter into a contract or arrangement, or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

(2) No person shall give effect to a provision of a contract, arrangement, or understanding that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

(3) Subsection (2) of this section applies in respect of a contract or arrangement entered into, or an understanding arrived at, whether before or after the commencement of this Act.

(4) No provision of a contract, whether made before or after the commencement of this Act, that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market is enforceable.”

In applying section 37, the Heavy Regulating Ministry of Transport may permit a contract, arrangement or understanding that has the effect of substantially lessening competition in a market if it is consistent with the broader public interest. Two conditions must be satisfying in applying the public interest test:

“(1) the contract, arrangement or understanding is necessary to meet a serious transportation need or to achieve important public benefits and

(2) if the need for those benefits cannot be met or achieved by reasonably available alternatives that are materially less anticompetitive.”

APPENDIX E - Air Service Agreement

Air Service Agreement between the Government of Country A and the Government of Country B (Willow, 1 March 1995)

Article I (Definitions)

For the purpose of this Agreement, unless otherwise stated:

- (a) "Agreed services" means scheduled air services on the routes specified in the Annex to this Agreement for the transport of passengers, cargo and mail;
- (b) "Agreement" means this Agreement, the Annex attached thereto, and any amendments to the Agreement or to the Annex;
- (c) "Convention" means the Convention on International Civil Aviation opened for signature at Chicago on the seventh day of December 1944 and includes any Annex adopted under Article 90 of that Convention and any amendment of the Annexes or of the Convention under Articles 90 and 94 thereof so far as those Annexes and amendments have been adopted by both Contracting Parties;
- (d) "Designated airline" means an airline or airlines which has been designated and authorised in accordance with Articles IV and V of this Agreement;
- (e) "Specified route" means a route specified in the Annex to this Agreement;
- (f) "Tariffs" means the prices which the designated airlines charge for the transport of passengers and cargo and the conditions under which those prices apply; and
- (g) "Territory", "Air service", "International Air Service", "Airline" and "Stop for non-traffic purposes" have the meaning respectively assigned to them in Articles 2 and 96 of the Convention.

Article II (Grant of rights)

1. Each Contracting Party grants to the other Contracting Party, except as otherwise specified in the Annex, the following rights for international air services:
 - (a) to fly without landing across its territory;
 - (b) to land in its territory for non-traffic purposes; and

(c) to land in its territory for the purpose of taking on board and discharging international traffic in passengers, cargo and mail while operating an agreed service.

Article III

(Change of aircraft)

(...)

Article IV

(Designation)

Each Contracting Party shall have the right to designate, by diplomatic note, an airline or airlines to operate the agreed services on the specified routes and to substitute, by diplomatic note, another airline or airlines for those previously designated.

Article V

(Authorisation)

1. Following receipt of a notice of designation or of substitution pursuant to Article IV of this Agreement, the aeronautical authorities of the other Contracting Party shall, consistent with its laws and regulations, grant without delay to the airline or airlines so designated the appropriate authorisations to operate the agreed services for which that airline has been designated.

Article VI

(Revocation and limitation of authorisation)

1. The aeronautical authorities of each Contracting Party shall have the right to withhold the authorisations referred to in Article V of this Agreement with respect to a designated airline of the other Contracting Party, to revoke or suspend such authorisations or impose conditions, temporarily or permanently:

(a) in the event of failure by the airline to qualify before the aeronautical authorities of that Contracting Party under the laws and regulations normally applied by those authorities in conformity with the Convention;

(b) in the event of failure by the airline to comply with the laws and regulations of that Contracting Party;

(c) in the event that the aeronautical authorities are not satisfied that substantial ownership and effective control of the airline are vested in the Contracting Party designating the airline or in its nationals; or

Article VII-Article IX

(...)

Article X

(Capacity)

1. There shall be a fair and equal opportunity for the designated airlines of both Contracting Parties to operate the agreed services on the specified routes between their respective territories.
2. In operating the agreed services the designated airline of each Contracting Party shall take into consideration the interests of the designated airline of the other Contracting Party so as not to affect unduly the services which the latter provides on the whole or part of the same routes.
3. The agreed services provided by the designated airlines shall bear a close relationship to traffic demand between the territories of the two Contracting Parties. The total capacity entitlement jointly decided pursuant to paragraph 5 of this Article shall be shared equally between the Contracting Parties for the use by their designated airlines.
4. Provision for the carriage of passengers, cargo and mail both taken up and discharged at points on the specified routes in the territories of third countries shall be made in accordance with the general principles that capacity shall be related to:
 - (a) traffic requirements to and from the territory of the Contracting Party which has designated the airline;
 - (b) traffic requirements of the areas through which the airline passes, local and regional air services being taken into account; and
 - (c) the requirements of economical through airline operations.
5. The capacity of the services to be operated by the designated airlines of the Contracting Parties may from time to time be agreed by the designated airlines of the Contracting Parties. The designated airlines of the Contracting Parties must submit capacity allocation for approval by the aeronautical authorities of both contracting States. Whether so agreed or unilaterally submitted by the designated airlines, capacity entitlements shall be jointly decided by the aeronautical authorities of both Contracting Parties.

Article XI-Article XII

(...)

Article XIII

(Tariffs)

1. The tariffs to be applied by the designated airline of each Contracting Party for the transportation of traffic on agreed services between the territories of the two Contracting Parties shall be established, in accordance with the provisions of this

Article, on the basis of the interests of users and the airline's own commercial judgement and assessment of market needs.

2. The tariffs referred to in paragraph 1 of this Article may be agreed between the designated airlines. At the option of the designated airlines, such agreement may be established in co-ordination with other airlines. Where agreement on a tariff cannot be reached between the designated airlines, each shall be entitled to establish a tariff individually.

3. The designated airlines of the Contracting Parties must file the tariffs referred to in paragraph 1 of this Article with the aeronautical authorities of the Contracting Parties. Such filing shall be made at least thirty (30) days before the proposed date of the introduction of tariffs or, in the case of matching filings, at least one (1) day before the proposed date of the introduction of the tariff. If within fifteen (15) days from the date of receipt, the aeronautical authority of one Contracting Party has not notified the aeronautical authority of the other Contracting Party that they are dissatisfied with the tariffs submitted to them, such tariffs shall be considered to be accepted or approved and shall come into effect on the date stated in the proposed tariff.

4. If during the period applicable in accordance with paragraph 3 of this Article a notice of dissatisfaction has been given, the aeronautical authorities of the Contracting Parties shall endeavour to determine the tariff by mutual consent. Consultations between the aeronautical authorities will be held in accordance with Article XVIII of this Agreement.

5. If the aeronautical authorities cannot agree on the determination of the tariff under paragraph 4 of this Article, the dispute shall be settled in accordance with the provisions of Article XX of this Agreement.

6. No tariff shall come into force if the aeronautical authorities of either Contracting Party have given notice of dissatisfaction in accordance with paragraph 3 of this Article.

Article XIV-Article XXI

(...)

Article XXII

(Entry into force)

The present Agreement shall enter into force as of 1 March 1995.

IN WITNESS WHEREOF, the undersigned, duly authorised thereto by their respective Governments, have signed this Agreement.

FOR THE GOVERNMENT OF Country A: [Signed:] Country B: [Signed:]

ANNEX

Country A–Country B Route Schedule

SECTION I

Routes for the designated airline of Country B

Country B via any points to two points in Country A (Bamboo and Willow).

SECTION II

Routes for the designated airline of Country A

Country A via any points to three points in Country B (Pear, Plum and Peach) and beyond to:

- (a) two points in Europe; and
- (b) two points in North America.

APPENDIX F - Route Map

